IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Augusta Division

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| IN RE: | ) | Chapter 7 Case |
| | ) | Number 90-11685 |
| WARREN DILLARD WATKINS, JR. | ) | |
| | ) | |
| Debtor | ) | |
| | ) | |
| E. HAROLD MAYS | ) | FILED |
| | ) | at 9 O'clock & 30 min. A.M. |
| Plaintiff | ) | Date: 5-24-91 |
| | ) | |
| vs. | ) | Adversary Proceeding |
| | ) | Number 90-1099 |
| WARREN DILLARD WATKINS, JR. | ) | |
| | ) | |
| Defendant | ) | |

MEMORANDUM AND ORDER

Before the court is a complaint by E. Harold Mays (hereinafter "creditor") against Warren Dillard Watkins, Jr., debtor in the underlying Chapter 7 case (hereinafter "debtor"), seeking a determination pursuant to 11 U.S.C. §523(a)(2) and/or (4) that debtor's obligation to creditor is nondischargeable. The creditor obtained a default judgment against debtor on June 29, 1990 in the Superior Court of Columbia County, Georgia. Creditor's judgment was obtained as a consequence of the debtor's failure to file responsive pleadings.

Creditor seeks a determination that the debt owed to the creditor is nondischargeable based upon fraud established by the state court default judgment. The creditor asserts that the debtor is collaterally estopped from relitigating the issue of dischargeability because the State court complaint alleges fraud as a cause of action. According to the creditor, the debtor is fraud has been established and relitigation of that issue is barred.

On December 17, 1990 a trial was held to determine the dischargeability of this debt and hearing was held on the creditor's contention that the debtor is collaterally estopped , from relitigating not only the debt but also the issue of fraud. At the hearing I denied the application of collateral estoppel to the State court judgment because the judgment was obtained by default, not litigated on the merits, and the standard of proof for dischargeability disputes alleging fraud is by clear and convincing evidence rather than the State law standard of proof for establishing liability by a preponderance of the evidence. The matter was tried on the merits and taken under advisement.

On January 15, 1991 the United States Supreme Court set a preponderance of the evidence standard of proof for 523 dischargeability actions. Grogan v. Gardner, ___ U.S. ____ 111 S.Ct. 654, 112 L.E.2d 755 (1991). Grogan overruled previously binding precedent in this circuit which had established the standard of proof as clear and convincing evidence. Hoskins v. Yanks (In re: Yanks), WL 63741 (11th Cir., May 13, 1991). In light of Grogan the creditor seeks reconsideration of my ruling on the collateral estoppel issue.

In Grogan the Supreme Court found "[t]hat collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to §523(a)." Grogan supra at N. 11, 111 S.Ct. at 658. Grogan further provides that the "application of that standard [preponderance of the evidence] will permit exception from discharge of all fraud claims creditors have successfully reduced to judgment." Grogan supra 111 S.Ct. at 661. Collateral estoppel applies in a §523(a)(2)(A) discharge exception based upon judgments established on liability for fraud. However, Grogan does not resolve whether collateral estoppel effect should be extended to default judgments.

In Grogan the plaintiffs brought a State law cause of action against the defendant alleging that he had defrauded them in connection with the sale of certain corporate securities. The matter was tried on the merits and a jury returned a verdict in favor of the plaintiffs awarding them actual and punitive damages. During

the pendency of an appeal, the bankruptcy proceeding was brought. The fraud judgment referenced in Grogan was a result of a trial on the merits. Following Grogan, the Eleventh circuit first addressed the change in the standard of proof in Yanks, supra. There the circuit court reversed a district court grant of discharge of a debt arising from a judgment based upon a tort of defamation under alternative theories that debtor had maliciously published a defamatory statement or that malice was implied by law. Relying upon Grogan the court found that

> [b]ecause the issues at stake and the standard of proof in the Florida defamation action and the dischargeability analysis under section 523(a)(6) are identical, [the creditor] is entitled to invoke the doctrine of collateral estoppel. In re: Yanks supra at 2.

However, the State court judgment in Yanks was based upon a jury verdict after a trial on the merits. Neither Grogan nor Yanks requires a change in my determination that no collateral estoppel effect on the fraud issue should be given to the State court default judgment.

The doctrine of collateral estoppel bars relitigation of an issue only if four requirements are met: (1) the issue at stake must be identical to the one involved in the prior litigation; (2) the issue must have been actually litigated in the prior litigation; (3) the determination of the issue was a critical and necessary part of the judgment in the earlier action [In re: Inker, 883 F.2d 986 (11th Cir., 1989); In re: Halpern, 810 F.2d 1061 (11th Cir., 1987); DeWeese v. Town of Palm Beach, 688 F.2d 731, 733 (11th Cir. 1982). In re: Stover 88 B.R. 479 (Bankr. S.D. Ga. 1988)] and (4) the burden of proof on the issue held to by the proponent of collateral estoppel must be the same or less in the present action than in the previous action. In re: Yanks supra at 2 N. 1.

To determine whether the condition necessary to grant collateral estoppel effect to an underlying State judgment was satisfied this court must review the

entire record of the State proceeding. In re: Latch, 820 F.2d 1163 (llth Cir. 1987): Balbirer

v. Austin, 790 F.2d 1524 (llth Cir. 1986): Spilman v. Harley, 656 F.2d 224 (6th Cir. 1981); Matter of Ross, 602 F.2d 604 (3rd Cir. 1979). In this case, the plaintiff has introduced from the State court proceeding a certified copy of the complaint and summons, return of service of the sheriff, default judgment entered by the court and Writ of Fieri Facias issued by the clerk. The default judgment stated:

> This action having become in default on May 26, 1990 by the failure of Defendant to file his answer or other defensive pleadings, and fifteen days having elapsed from the date of default and the default not having been opened as a matter of right or by Order of the Court:
>
> a. It is ORDERED AND ADJUDGED that Plaintiff recover of Defendant under count 1 of the Complaint in the sum of $30,000.00, plus interest of $4,390.00, plus attorney fees of $5,158.50, plus future interest as provided by law, plus all costs of Court as taxed by the Clerk.
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> b. And the issue of damages under count 2 of the Complaint having been tried before the Court without a jury, and the Court finding from the evidence that Defendant committed fraud upon the Plaintiff as set out in count 2 of the Complaint and that Plaintiff incurred a loss as a result thereof in the sum of $28,000.00, and a decision having been rendered by the Court for the Plaintiff, and against the Defendant, in the sum of $28,000.00, plus interest at the rate of 12% per annum from April 23, 1989 in the sum of $3,920.00, it is ORDERED AND ADJUDGED that Plaintiff recover of the Defendant under count 2 of the Complaint the sum of $28,000.00, plus interest of $3,920.00, plus future interest as provided by law and plus all costs of Court as taxed by the Clerk.
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> c. It is further ordered that execution issue for the aforesaid sums.

In this case the only matter of record introduced into evidence to support the collateral estoppel argument of the creditor is the default judgment. While the default judgment does recite a finding of fraud, it is entirely void of any findings of fact and conclusions of law to substantiate the necessary elements

to apply collateral estoppel. See Key v. Wise, 629 F.2d 1049, 1061 (5th Cir., 1980)[1] (emphasizing the need for a Federal Trial Court's record and factual findings for review purposes). From the record before me it is impossible to determine that the issues presented in the prior State proceeding and the issue tried in this adversary proceeding were identical, or were actually litigated in the prior case. "It has been firmly established in this Circuit that a mere default judgment will not be given estoppel effect." Jamison v. Maner (In re: Maner) Chpt. 7 case No. 90-20400, Adv. Pro. No. 902021 (Bankr. S.D. Ga. Brunswick Division, Davis, C.J. December 20, 1990) [citing: DeWeese, supra; In re: Held, 734 F.2d 628,629 (11th Cir. 1984); In re: Latch, supra.]

In this case, the Superior Court in the default judgment did recite "[t]he issue of damages under count 2 of the Complaint having been tried before the court without a jury and the court finding from the evidence that Defendant committed fraud upon the

Plaintiff as set out in count 2 of the Complaint . . . ", however, the debtor failed to file responsive pleadings and failed to appear at the trial conducted by the superior court.

> On balance denial of issue preclusion [collateral estoppel] . . . seems appropriate in cases that involve a one sided hearing after default for failure to answer . . . Although such hearings may involve both presentation of proof and decision of the issues presented, the procedure is apt to be to remote from full adversary contest to support issue preclusion. If a contested hearing is held, on the other hand, issue preclusion may prove appropriate. Preclusion is thus fully appropriate as to any issue resolved after a full scale contest on issues of damages. So too, preclusion may be appropriate if hearings on issues of liability have come reasonably close to a full-scale trial.

18 Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction

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[1]The Eleventh Circuit has adopted all decisions rendered by the Fifth Circuit on or before September 30, 1981 as binding precedent in this circuit. Bonner v. City of Prichard, 661 F.2d 1206 (11th Cir. 1981).

§4442 (1981). In this case there was no full scale contest on the issues. The debtor did not contest the action and the judgment was taken by default. Denial of collateral estoppel effect to the judgment merely required the creditor to prove his case in a fully contested trial. The decision of the United States Supreme Court in Grogan does not alter the foregoing analysis, therefore the creditor's request for reconsideration of my denial of collateral estoppel effect to the superior court judgment is denied. Based upon testimony, and evidence introduced at trial I make the following findings of fact and conclusions of law.

FINDINGS OF FACT

The creditor and debtor have known each other for the last 12 years. Within that time the parties have engaged in various business transactions. In April, 1990 the debtor was indebted to the creditor in the amount of Thirty Thousand and No/100 ($30,000.00) Dollars as evidenced by a promissory note. The debtor approached the creditor with a proposed business venture consisting of the creditor investing the sum of Twenty-Eight Thousand and No/100 ($28,000.00) Dollars to promote a "Willie Nelson" music concert at the riverfront in Augusta, Georgia. The debtor promised the creditor that for his investment he would receive a one-half interest in the concert's profits. The parties agreed that the profits received by the creditor would be credited toward repayment of the Thirty Thousand and No/100 ($30,000.00) Dollar debt. The creditor paid to the debtor the sum of Twenty-Eight Thousand and No/100 ($28,000.00) Dollars. The creditor testified that he believed that his Twenty-Eight Thousand and No/100 ($28,000.00) Dollar investment represented one-half of the total necessary investment and that the other half had already been paid. No evidence was introduced as to whether any other investment was made.

The day following receipt of the Twenty-Eight Thousand and No/100 ($28,000.00) Dollars, the debtor paid to JMA Promotions the sum of Twenty Five Thousand and No/100 ($25,000.00) Dollars. JMA Promotions was the actual entity promoting the concert. The debtor testified that the balance, Three Thousand and

No/100 ($3,000.00) Dollars was retained by him and invested in fencing and other security measures and area clean up prior to the concert. The

debtor's testimony was uncontroverted. The concert was held, but was a financial failure. The creditor never received any return of his investment nor accounting of receipts and expenses.

CONCLUSIONS OF LAW

Creditor asserts that the portion of his State judgment relative to the Twenty-Eight Thousand and No/100 ($28,000.00) Dollar payment represents a nondischargeable obligation of the debtor pursuant to 11 U.S.C. §523(a)(2)(A) or (4).[2] Regarding the §523(a)(2)(A) allegation, in order to exclude from discharge a particular debt based upon fraud or false representation, the creditor must prove that:

1) The debtor made a false representation
2) with the purpose and intention of deceiving the creditor;
3) the creditor reasonably relied upon that representation; and 4) the creditor sustained a loss as a result of that representation.

[2]11 U.S.C. §523(a)(2)(A) & (4) provide:

> (a) A discharge under section 727, 1141, 1228(a), 1128(b) or 1328(b) of this title does not discharge an individual debtor from any debt
> (2) for money, property, services, or an extension, renewal, or financing of credit, to the extent obtained, by
> (A) false pretenses, a false misrepresentation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

In re: Hunter, 780 F 2d 1557 (11th Cir. 1986). Exceptions to discharge are to be narrowly construed. Hunter id. at 1579 quoting Glisson v. Thaw, 236 U.S. 558, 35 S.Ct. 287, 59 L.E. 17 (1915). A creditor seeking to have a debt determined to be nondischargeable under 523 bears the burden of proving each element. In re: Fontana, 92 B.R. 559 (Bankr. M.D. Ga. 1988). That proof must be established by a preponderance of the evidence. Grogan supra.[3]

From the evidence presented the creditor has failed to establish fraud by a preponderance of the evidence necessary to establish the debt as nondischargeable. The facts of this case are that the debtor offered the creditor a business proposition and the creditor took it. The creditor invested Twenty-Eight Thousand and No/100 ($28,000.00) Dollars in a concert promotion which concert took place and was a financial failure. The burden of proof rests with the creditor. The proof in this case is that the creditor lost his investment, not that the debtor defrauded the creditor. Twenty Five Thousand and No/100 ($25,000.00) Dollars of the Twenty-Eight Thousand and No/100 ($28,000.00) Dollar investment was paid over to JMA Promotions to promote the concert and the balance, Three Thousand and No/100 ($3,000.00) Dollars, was invested by the debtor in fencing, security and site clean up for the concert. The

creditor failed to establish that the debtor made a false representation. From the evidence, the creditor's Twenty-Eight Thousand and No/100 ($28,000.00) Dollars was invested in the concert and the concert failed. There was no evidence one way or the other on whether there were other investors. What was proven was that the creditor lost his money on a speculative venture. The burden is on the creditor to prove fraud, not on the debtor to prove

[3]As previously noted, this case was tried under the then standard of clear and convincing evidence. Because the judgment in this case is rendered for the debtor, neither party was prejudiced by this change in standard of proof to preponderance of the evidence.

that he did not defraud.

Regarding the creditor's contention that the debtor committed fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny, the evidence does not support such finding. Section 523(a)(4) provides three separate bases for excepting an obligation from discharge. In order to establish "fraud or defalcation while acting in a fiduciary-capacity" the "fiduciary capacity" must be based upon a technical trust, express trust or statutorily imposed trust. The term does not apply to fiduciary relationships which arise out of equitable or implied trust or trust implied by law as arising out of contract. American Express Travel Related Services Company, Inc. v. Solomon, (In re: Solomon) Chpt. 7 case No. 89-50120 Adv. Proc. No. 90-5001 (Bankr. S.D. Ga. Waycross Division Davis, J. September 13, 1990); Atchley v. Stover (In re: Stover) Chpt. 7 case No. 87-41160 Adv. Proc. No. 88-4003 (Bankr. S.D. Ga. Savannah Division, Dalis, J. July 18, 1988); In re: Owens, 54 B.R. 162 (Bankr. D.S.C. 1984); In re: Ogg, 40 B.R. 609 (Bankr. N.D. Tex. 1984). The trust must specifically spell out the duties

of the fiduciary. In re: Angelle, 610 F.2d 1335 (5th Cir., 1980). From the evidence in this case, no technical, expressed nor statutorily imposed trust existed between the parties. The relationship between the parties was based upon an arms-length business deal.

A debt arising through embezzlement or larceny are also nondischargeable under §523(a)(4).

> Embezzlement is the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come. A difference from larceny and the fact that the original taking of the property was lawful, or with the consent of [the] owner, while in larceny the felonious intent must have existed at the time of the taking. L. King Collier on Bankruptcy §523.14[3] (15th ed. 1990) [citing Black's Law Dictionary (4th revised ed.)].

Embezzlement under §523(a)(4) requires a determination that (1) property of another must be entrusted to a debtor, (2) the debtor must appropriate the

properties for use other than that for which it is entrusted and (3) the circumstances must indicate fraud. In re: Burgess, 106 B.R. 612 (Bankr. D.Neb. 1989). In this case, the evidence indicates that the money entrusted to the debtor was either paid to JMA Promotions, the promoter of the concert, or used by the debtor in preparation for the concert. From the evidence, the creditor has failed to establish by a preponderance of the evidence any misappropriation. To establish larceny, the creditor must prove that the original taking of the property was unlawful. The evidence introduced at trial clearly establishes that the creditor freely

gave the money to the debtor. There was no larceny or theft.

The creditor, E. Harold Mays, having failed to establish actual fraud, fraud or defalcation while acting in the fiduciary capacity, embezzlement or larceny by a preponderance of the evidence judgment is ORDERED entered for defendant Warren Dillard Watkins, Jr. determining the debt due the creditor, E. Harold Mays, discharged in the debtor's underlying Chapter 7 bankruptcy case. No monetary damages are awarded.

JOHN S. DALIS
UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia
this 23rd day of May, 1991.